State of Wisconsin • DEPARTMENT OF REVENUE

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Jim Doyle
Governor

Roger M. Ervin
Secretary of Revenue

Ways and Means Committee Hearing, March 7, 2007

Assembly Bill 28 - Creating an Individual Income Tax Credit for Retirement Plan Income Received by an Individual (Representative Lothian)

Description of Current Law and Proposed Change

Under current law, the pension benefits of certain public employees are exempt from state taxation. The pensions that are exempt include the U.S. Civil Service, Milwaukee city and county, Milwaukee police officers and public school teachers, Wisconsin state teachers' retirement fund, and the sheriff's annuity and benefit fund of Milwaukee County. For these plans, the exemption only applies to persons who were members of or were retired from the plans on December 31, 1963.

Beginning in tax year 2008, this bill would provide an income tax credit based on taxpayers' marginal tax rates multiplied by up to $2,500 of income received from a qualified retirement plan if that income is taxable. The maximum allowable retirement income for the purpose of calculating the credit would increase from $2,500 to $5,000 in 2009, $10,000 in 2010, $15,000 in 2011, and $20,000 in 2012 and thereafter.

Fairness/Tax Equity

- Wisconsin's taxation of pension income is generally the same as the federal tax treatment, apart from the special exemptions for state and local government, federal civil service, and military pensions. Other than the military pensions, the currently exempt pensions will, in effect, be phased out over time. The youngest people who were members of the qualifying pension plans in 1963 are currently in their mid-sixties. In general, pension income is taxable except for the portion attributable to the employee's contribution.

- Under current law, all social security income will be exempt from taxation beginning in tax year 2008. The bill provides more equal treatment for retirees who are covered only by their employer's pension plan and who do not receive social security benefits. For example, the bill would partially address the inequity created by the social security exemption with regard to federal retirees. Federal workers who retired between 1964 and 1983 may receive a federal pension instead of social security benefits. These workers would not benefit from the social security exemption, whereas federal workers retiring after 1984 who do receive social security payments would benefit from the exemption.

- Individuals with exempt retirement income under the bill currently account for 20% of filers, 22% of adjusted gross income reported on Wisconsin individual income tax forms, and 22% of all individual income tax. The average adjusted gross income of filers with exempt retirement income is $5,500 higher than filers without qualifying retirement income ($50,200 compared to $44,700). In tax year 2012, the credit would reduce this group's income tax liability by 18% to 23%. This is in addition to the 7% reduction in this group's liability due to the social security exemption.

Impact on Economic Development

- A tax preference for pension income will increase the value of pension plans for employees. This may encourage some employers to provide pensions when they otherwise would not and it may encourage some employers to provide more generous pensions than they would otherwise provide. The extent to which this would occur is unknown, but likely to have a marginal effect.

- The proposed credit may encourage some elderly persons to stay in Wisconsin rather than move to other states, or encourage elderly persons from other states to move here.

- On the other hand, according to the U.S. Census Bureau, the net elderly migration rate out of Wisconsin was 5.63 people per 1,000 during the 1995-2000 period. As an annual percentage rate, the net out migration of elderly individuals averaged 0.113% per year during the 1995-2000 period. Wisconsin's neighboring states all have higher net out migration rates for the elderly than Wisconsin. The net out migration rates per 1,000 elderly residents during the 1995-2000 period were 28.1 in Illinois, 11.2 in Iowa, 17.7 in Michigan, and 10.3 in Minnesota.

Administrative Impact/Fiscal Effect

- Using the 2005 Individual Income Tax Model, inflated for 2008 income levels and law, a credit based on up to $2,500 for each person with retirement income would reduce taxes on approximately 405,000 returns. State income tax revenues would decrease by $54 million to $83 million for tax year 2008. A range, rather than a specific amount, is given because tax returns do not include information about the source of pension distributions for married couples. The lower bound assumes that all pension income is attributed to one spouse, while the upper bound assumes that the pension income is divided evenly between both spouses. Apportioning the tax year effect to fiscal years, the fiscal year 2008 revenue impact would be $24 million to $37 million.

- State income tax revenue is estimated to decrease by $75 million to $113 million for fiscal year 2009, $136 million to $198 million for fiscal year 2010, $211 million to $297 million for fiscal year 2011, and $276 million to $376 million for fiscal year 2012.

The Department has raised the following technical concerns related to the bill:

- Although the bill appears to allow each spouse to claim the credit when married persons file a joint return, this could be more clearly stated.

- For a full-year resident of Wisconsin, exempt retirement income cannot be used in the computation of the credit. At the same time, a nonresident or part-year resident of Wisconsin can use retirement income not taxable to compute the credit.

- The computation of the credit may be confusing to taxpayers. The taxpayer will have to determine his/her marginal tax rate in order to compute the credit. This is especially difficult for nonresidents and part-year residents. They would be required to prorate each tax bracket before determining marginal tax rates and then do a second proration for the credit.

- It is unclear whether it is intended that the credit be allowed for Individual Retirement Accounts distributions, including early distributions.

- Current law provides a penalty for certain distributions from a retirement plan. The penalty does not apply to certain distributions that are exempt from Wisconsin income tax. It is unclear if the penalty would apply to the proposed credit.

- It is unclear whether a person can claim both the disability income exclusion and the credit.

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State Senator
Neal J. Kedzie
11th Senate District

Assembly Committee on Ways and Means
March 7, 2007, 300 Northeast
Public Hearing on Assembly Bill 28
State Senator Neal Kedzie

Good morning Chairperson Kerkman and Committee members. Thank you for your consideration and review of Assembly Bill 28, the pension income tax relief bill.

Assembly Bill 28 is very straightforward. If enacted, a significant portion of an individual's pension or retirement income will be tax-free within five years.

Beginning with tax year 2008, a portion of a recipient's pension will would be exempt from state taxes. Those amounts would increase in subsequent years as follows:

- Tax year 2008: $2,500 of pension income exempt
- Tax year 2009: $5,000 of pension income exempt
- Tax year 2010: $10,000 of pension income exempt
- Tax year 2011: $15,000 of pension income exempt
- Tax year 2012 and thereafter: $20,000 of pension income exempt

Assembly Bill 28 includes all qualified pension, profit-sharing, and stock bonus plans under the Internal Revenue Code, deferred compensation plans offered by state and local governments and tax-exempt organizations under the IRC, self-employed plans, tax-sheltered annuities, and individual retirement accounts.

This is a bill I have been pushing for more than six years. I originally considered it after Illinois transplant constituents brought it to my attention. As you may know, Illinois is one of 12 states that exclude all pension income from taxation. In fact, Wisconsin is one of only 7 states that don't have some type of broad exclusion or targeted tax credit aimed to assist seniors.

Wisconsin's tax burden on seniors leads many to consider moving once they retire. I have also heard many stories of retirees who move here, then consider moving back to where they originally came because of this state's tax burden. We as a state can not continue to be that hostile to our seniors . . . They are a very valuable resource for our state and communities for many reasons, including their ability and interest to volunteer and participate in public service.

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Passing this legislation will not only lead to more seniors staying in Wisconsin, but also lead to seniors spending more money in Wisconsin, which no doubt will be a boon to our economy. According to the U.S. Administration on Aging, senior citizens in America control approximately 50 percent of all discretionary income and spend more than $60 billion annually. For example, 40 percent of all money spent on household furnishings is attributed to seniors, as well as the group spending 37 percent above the average on apparel and 30 percent above the average on food. At the last census, Wisconsin had 1.6 million citizens over the age of 50, a number that is sure to grow with the retirement of the baby boomers.

Assembly Bill 28 will create financial security for all Wisconsin senior citizens and retirees. I believe this measure is a positive step towards real tax relief and greater financial freedom.

Representative Lothian and I would like to thank the 41 other legislators who support this bill as well and have signed on as co-sponsors.

Again, thank you for your time and consideration and I'd be happy to answer any questions you may have.